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Dealing Rates		
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EUR/USD	1.0654	1.0658



Martin Wolf: Wide-awake China

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Published: November 11 2003 20:21 | Last Updated: November 11 2003 20:21

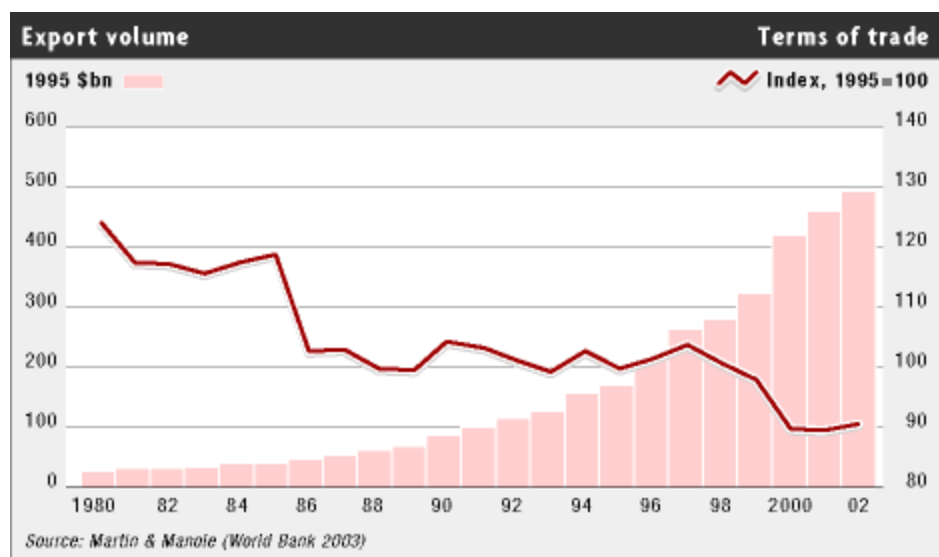
*Let China sleep, for when she wakes, she will shake the world.*

Until recently, the world happily ignored Napoleon's warning. But China is now shaking the world. The US was the first continental, capitalist, economy. The European Union is trying to become a second. Potentially, China dwarfs them both. Already, it is a big, and controversial, presence in the global economy. Its impact is certain to increase still further. Fear is an inevitable response to this growing upheaval. But how far is it justified? And what is the best response?

China's trade performance has, indeed, been astonishing. Between 1980 and 2002, China's share in global exports and imports rose from 1.2 per cent and 1.1 per cent, to 5.2 per cent and 4.2 per cent, respectively. From 1993 to 2002, the volume of China's exports of goods rose at an annual rate of 17.3 per cent. If current trends were sustained (which is unlikely), China's exports would surpass those of the US by about 2010. Over the 12 months to May 2003, Chinese exports of \$366bn were the world's fourth largest, after those of the US, Germany and Japan. Its imports, at \$323bn, were the sixth largest, but will soon be bigger than those of Japan, the UK and France.

This growth recalls that of Japan. But China's expansion is different, in at least two respects. First, China's economy is far more open: its ratio of trade to gross domestic product, at market prices, was 44 per cent in 2001, while Japan's was only 18 per cent. Second, China's exports are far more dependent on inward direct investment: in 2000, according to the United Nations' *World Investment Report*, half China's exports came from foreign affiliates. China will be a bigger force in the world economy than Japan, not only because its potential is far larger but also because it will be far more deeply integrated within it.

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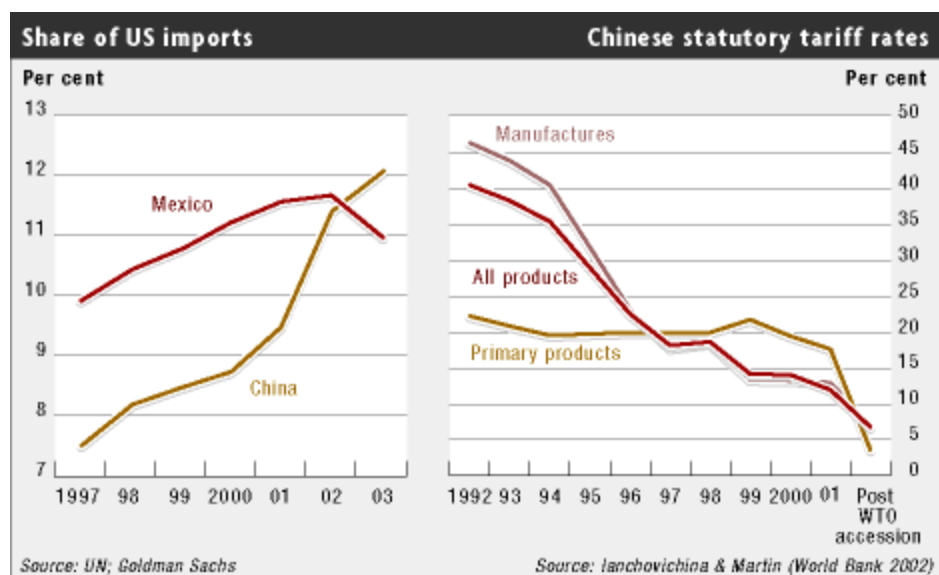


To assess the impact of China's trade, one must start with its comparative advantage and trade policies. The former rests on almost limitless supplies of cheap labour. The latter have become remarkably liberal. In 1992, average statutory tariffs on manufactures were 46.5 per cent. After accession to the World Trade Organisation, this will be down to 6.9 per cent. For primary products, the decline is from 22.3 to 3.6 per cent. China also reduced the coverage of non-tariff barriers from 32.5 per cent of imports to 21.6 per cent between 1996 and 2001.\* This liberalisation further increases the competitiveness of China's exports, because a tax on imports is also a tax on exports.

Between 1979 and 2001, China's terms of trade - the ratio of the prices of its exports to those of its imports - fell by 30 per cent.\*\* As China's growth drives down the relative price of her exports, countries that compete in third markets suffer declining profitability and market shares. But net importers of China's exports and net exporters of her imports benefit. In general, commodity exporters and exporters of sophisticated goods and services gain, while other labour-abundant countries lose.

An analysis of the impact on Latin America by Goldman Sachs ("The Sweet and Sour Effects of China in Latin America", November 7 2003), notes that Mexico is a loser, while Argentina, Brazil and Chile - all big commodity exporters - are gainers. Last year, for example, China overtook Mexico as a supplier of manufactures to the US market. China's wages were still about a quarter of Mexico's in 2002, even though they have been soaring. Mexico's productivity is not rising fast enough to offset this Chinese advantage. As Mexico loses market share, it also risks losing inward foreign direct investment. This explains, in part, why inward FDI fell from \$25bn in 2001 (admittedly, a very high level) to \$14bn in 2002. In all, argues Goldman Sachs, the impact of China on Mexico's balance of payments amounts to 4 per cent of gross domestic product, which could increase further.

What has been bad for Mexico has been good for Argentina, Brazil and Chile, which have enjoyed rising trade surpluses with China. Goldman Sachs estimates the positive impact on Argentina and Brazil at 0.75 per cent of their combined 2003 GDPs. Gains come to other commodity exporters, as well. Among them are Australia and New Zealand and the oil exporters, which now possess a voracious market in the decades ahead.



Gains are even available to countries that would seem vulnerable to direct Chinese competition. The reason is the vertical integration of Chinese production. In 1998, just under a quarter of the value of Chinese exports contained direct and indirect imports. Not surprisingly, such production is particularly relevant to China's neighbours. Another World Bank study notes, for example, that between 1985 and 2001, exports from other east Asian emerging market economies to China grew from \$5.9bn to \$83.5bn. In 2001, 15 per cent of east Asia's exports to China consisted of parts of office machines and telecommunications equipment and electronic microcircuits, all of which were for assembly and re-export.\*\*\*

How should other countries respond to the Chinese shock? "Calmly" is the best advice.

One reason is economic: the most adversely affected countries can do little about China's rise, while those that can do something also benefit most from it. Unless Mexico can persuade its trading partners to increase their protectionist barriers against China, on a discriminatory basis, it can do nothing to remedy the adverse impact. But net importers from China are gainers. Imposing protection is to inflict losses upon themselves.

But the bigger reason for calm comes from history. If China is permitted to thrive as a dynamic exporter of cheap manufactures, its people will obtain the prosperity they want. If China is thwarted by protectionist barriers, its people will be correspondingly frustrated and dangerous.

The challenges of accommodating a wide-awake China will be huge. But they can - and must - be risen to.

\* Elena Ianchovichina and Will Martin, *Economic Impacts of China's Accession to the WTO*, World Bank, December 11 2002;

\*\* Will Martin and Vlad Manole, *China's Emergence as the Workshop of the World*, World Bank, 15 September 2003;

\*\*\* Francis Ng and Alexander Yeats, *Major Trade Trends in East Asia*, World Bank Policy Research Working Paper 3084, June 2003.

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